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IN THE
Supreme Court of the United States

OCTOBER TERM 1940

No. 324

HARRY C. DAVIS, C. J. ROOT and ROY HOLLIS,
PETITIONERS

versus

CITY OF HOMESTEAD, FLORIDA, and THE UNITED STATES OF AMERICA (Intervenor),
RESPONDENTS.

BRIEF OF RESPONDENT
City of Homestead, Florida

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IN THE SUPREME COURT OF THE UNITED STATES

October Term 1940

No. _____

HARRY C. DAVIS, C. J. ROOT and ROY HOLLIS,
PETITIONERS

versus

CITY OF HOMESTEAD, FLORIDA, and THE UNITED STATES OF AMERICA (Intervenor),
RESPONDENTS.

Brief on Behalf of Respondent, City of Homestead, Florida, on Petition for Writ of Certiorari of Harry C. Davis, C. J. Root and Roy Hollis to the United States Court of Appeals, Fifth Circuit.

STATEMENT OF THE CASE

On May 3, 1939 the City of Homestead, Florida, filed a Petition in the District Court for a composition of its bonded indebtedness based on the terms set forth in a Refunding Contract and Agreement

dated October 18, 1937. The petition filed by the City of Homestead in the District Court recited and set forth the Refunding Agreement for the purpose of showing the terms upon which the proposed composition was based and the purpose and intent of the City to refund its entire bonded indebtedness upon the terms therein suggested. (R. 20-32) (See also, Resolution No. 400 (R. 32-47)).

The agreement and resolution provided that the City would refund the bonds of all creditors, whether the owners of the bonds were parties to the agreement or not (R. 30).

The agreement further provided that when "not less than seventy-five per cent of the principal amount of the outstanding bonds of the City of Homestead" had agreed, "then the said City of Homestead, Florida, will proceed to do all things hereinbefore provided, and this agreement then becomes operative and effective between the respective parties hereto."

In this statement of the case we set forth the above data and facts to show that the City of Homestead, Respondent herein, did not contemplate merely a 75% refunding of its obligations, as stated by Petitioners here, and only with the signers of the agreement, but a refunding of 100% of its entire debt.

It serves no useful purpose in this statement of the facts of the case to state the provisions of the refunding or adjustments relative to the levies or other means therein provided for the payment of the bonds or certificates, except to say, they are to

be paid by general ad valorem levies. In accordance with the terms and provisions of the refunding agreement and resolutions, refunding bonds and coupon certificates to the total amount of 100% of the debts of the City were validated and placed with a fiscal agent for exchange. As stated by Counsel for the Petitioners herein in his statement of the case—at the time of the filing of the petition in the District Court, 84% of the total outstanding debts had been refunded and the holders of more than 51% of the obligations of the City "affected by the Plan" had consented (R. 16-18).

The District Court approved the filing of the Petition and ordered a hearing in the usual manner. The Petitioner here, Roy Hollis, filed an answer and objections to the Plan of Composition (R. 80-85), and Harry C. Davis and C. J. Root moved the Court to dismiss the petition (R. 86-89, 102-105). The answer and motions to dismiss alleged, among other things, that Section 83 (j), if construed to authorize the inclusion of consents of owners of refunded bonds and certificates in the 51% consenting creditors required by the Municipal Bankruptcy Act for the filing of the petition, and 66 2/3% necessary for the confirmation of the plan, would violate the Fifth and Tenth Amendments to the Constitution of the United States of America (R. 87-96, 103-104, 111-112).

The United States intervened and suggested that the objections raised by the Petitioners be overruled, and the District Court denied the motions to dismiss and the answer insofar as the same relates to the legal questions raised in the motions to dismiss.

An appeal was taken to the Circuit Court of Appeals for the Fifth Circuit from the order denying the motions to dismiss and the "legal questions of similar import in the answers" (R. 117).

The Circuit Court of Appeals for the Fifth Circuit affirmed the ruling of the lower court. (Harry C. Davis, et al., v. City of Homestead, Florida, et al., 112 F. (2d) 438) Advance Opinions, July 22, 1940. (R. 130-132). Rehearing denied by the Circuit Court of Appeals for the Fifth Circuit, without opinion, July 8, 1940 (R. 152).

In the Petition for Writ of Certiorari, counsel emphasizes the provisions of the Refunding Contract and Agreement, claiming that the same became final when 75% of the holders of the outstanding bonds of the City had signed the agreement and that this was the consummation of the original Plan for refunding. The Refunding Contract and the Petition filed in the District Court clearly show that this was not the finality of the refunding plan, but the beginning, and that it was the purpose and intent of not only the City, but of those who signed and those who accepted refunding bonds that it should be a 100% refunding. The holders of the unrefunded securities (Petitioners for Writ of Certiorari), insist that Section 83 (j), Chapter IX of the Bankruptcy Act, August 16, 1937, as amended by the Act of June 22, 1938 (11 U. S. C. A. 403 (j)), does not afford the City of Homestead the relief sought in the District Court.

We look to the original Act before amendment for the authority for the procedure, and to the

amendment, sub-section (j), for an extension of the relief afforded by the original Act to public debtors having theretofore voluntarily attempted to adjust their obligations.

We quote the amendment, with our emphasis noted:

> "(j) **The partial completion** or execution of any plan of composition as **outlined in any petion** filed under the terms of this act by the **exchange of new evidences** of indebtedness under the plan for evidences of indebtedness covered by the plan, whether such partial completion or execution of such plan of composition **occurred before or after the filing** of said petition, shall not be construed as **limiting** or **prohibiting the effect of this act,** and the written consent of the **holders of any securities** outstanding as the result of any such partial completition or execution of any plan of composition **shall be included as** consenting creditors to such plan of composition in determining the percentage of **securities affected by such plan of composition."**

This is a companion case to the case of American National Bank of Nashville, Tennessee, versus City of Sanford, Florida, et al., 112 F. (2d) 435, also before the Court on a Petition for Writ of Certiorari.

ARGUMENT

The sole question involved is the construction of Section 83 (j) of the Bankruptcy Act as amended (11 U. S. C. A. 403 (j)), and its constitutionality under the Fifth and Tenth Amendments to the Constitution of the United States.

Section 83 (j), construed to require the inclusion of the holders of the new refunding bonds or certificates among the creditors owning 51% of the bonded indebtedness consenting to the filing of a plan of composition, is constitutional.

Section 83 (j), construed to require the inclusion of the holders of the new refunding bonds or certificates among the creditors owning 66 2/3% of the bonded indebtedness consenting to the confirmation of the plan of composition, is constitutional.

Counsel for the Petitioners has seen fit to divide his argument into four points, and the same order will be observed for convenience in this brief.

POINT I

The Decision of the Circuit Court of Appeals Approving Majority Consents of Creditors Having Irrevocably Scaled their Debts Conflicts with the Decision of the Eighth Circuit in this Matter, in Luehrmann v. Drainage Dist. No. 7.

There is no conflict, express or implied, between the decision of the Circuit Court of Appeals of the Fifth Circuit in this case and the decision of the Circuit Court of Appeals of the Eighth Circuit in the

case of Luehrmann v. Drainage Dist. No. 7 of Poinsett County, Ark., 104 F. (2d) 696.

The objection raised by the non-assenting bondholders in the Luehrmann case is as follows:

> "2. The bondholders who have already scaled their debts before this petition was filed cannot be counted as preliminary acceptors of the plan, nor as part of the two-thirds ultimately necessary to the confirmation of the plan." (p 699).

In considering and in overruling this objection and thereby not showing any conflict with either the City of Sanford or the City of Homestead cases, the Court said:

> "(7) The next and final specification of objection in the Luehrmann appeal is that the plan to pay all bondholders 25.879 cents on the dollar 'discriminates unfairly against non-assenting bondholders because it would compel these appellants, as holders of liens, to relinquish these liens to the petitioners without just compensation'. This involves a consideration of the nature and effect of composition proceedings under the provisions of the Bankruptcy Act. In support of this contention appellant relies strongly upon the holding of the Supreme Court in the Louisville Joint Stock Land Bank v. Radford, 295 U. S. 555, 55 S. Ct. 854, 79 L. Ed. 1593, 97 A. L. R. 1106, that the bankruptcy power is subject to the Fifth Amendment, U. S. C. A. Const., and that private property shall not be taken even for a wholly public use without just compensation. But in this

opinion (295 U. S. loc. cit. 585, 586, 55 S. Ct. loc. cit. 861, 79 L. Ed. 1593, 97 A. L. R. 1106) some very pertinent and distinguishing language concerning compositions is used: 'So far as concerns dissenting creditors, the composition is a method of adjusting among creditors rights in property in which all are interested. In ordering the adjustment, the bankruptcy court exercises a power similar to that long exercised by courts of law. (Citing cases). It is the same power which a court of equity exercises when it compels dissenting creditors, in effect, to submit to a plan of reorganization approved by it as beneficial and assented to by the requisite majority of the creditors. (Citing cases). In no case of composition is a secured claim affected except when the holder is a member of a class; and then only when the composition is desired by the requisite majority and is approved by the court. Never, so far as appears, has any composition affected a secured claim held by a single creditor. Compositions are comparable to the voluntary adjustment with the mortgagee provided for in paragraph 3 of the Frazier-Lemke amendment (11 U. S. C. A. Sec. 203(s) (3)). They are not analogous to the so-called adjustment compelled by paragraph 7, (11 U. S. C. A. Sec. 203(s) (7)).'

"This view of compositions is foreshadowed by the opinion of the same court in Continental Illinois Nat. Bank v. Chicago, Rock Island & P. Railway Company, 294 U. S. 648, 673, 674, 55 S. Ct. 595, 605, 79 L. Ed. 1110, construing and upholding Section 77 of the Bankruptcy Act, added by

> the Act of March 3, 1933, 11 U. S. C. A. Sec 205: 'The confirmation and legalization of "a scheme of arrangement" under such circumstances is no more than is done in bankruptcy when a "composition" agreement with the bankrupt debtor, if assented to by the required majority of creditors, is made binding on the non-assenting minority. In no just sense do such governmental regulations deprive a person of his property without due process of law. * * * Every member of a political community must necessarily part with some of the rights which, as an individual, not affected by his relation to others, he might have retained."

Further, there is no conflict in any decision that we have been able to find rendered since the adoption of the Municipal Bankruptcy Act in any Circuit which in any manner conflicts with the decisions in the Homestead and Sanford cases. To the contrary, they support and complement these cases.

United States v. Bekins, et al.,
304 U. S. 27, 58 S. Ct. 811.

In re Corcoran Irr. Dist.,
27 F. Supp. 322 (D. C. Cal.)

In re City of Ft. Lauderdale,
(D. C. Fla.) 23 F. Supp. 229.

In re Drainage Dist. No. 7 of Poinsett
County, Ark., 25 F. Supp. 372 (D. C. Ark.)

In re Merced Irr. Dist.,
25 F. Supp. 981 (D. C. Cal.)

Vallette, et al., v. City of Vero Beach, Fla., 104 F. (2d) 59. (Certiorari denied Oct. 9, 1939), 60 S. Ct. 110.

In re B. & O. R. R. Co., 29 F. Supp. 608 (D. C. Md.)

Campbell v. Alleghany Corp., 75 F. (2d) 947.

In re Wichita Falls & Southern Ry. Co., 30 F. Supp. 750 (D. C. Tex.)

Great reliance is placed by Petitioners for the writ upon the provisions in the Homestead Refunding Agreement that the securities surrendered were to be cancelled and, therefore, the refunding bonds were new obligations of a separate class apart and from the bonds not refunded. However, the Supreme Court of the State of Florida, relative to refunding obligations, has said:

> "Thus refunding bonds are not only obligations in themselves for what they purport to be on their face and under the statutes pursuant to which they are issued, but are authorized extensions and continuations of the obligations represented by the bonds that are refunded by them, which original obligations are not extinguished by, but are merged into, the refunding bonds with like force and effect as if the original bonds had remained unrefunded by the issuance of such refunding bonds." State ex rel Pinellas County v. Sholtz, 155 So. 736, Bay County et al v. State, 157 So. 1.

It therefore appears that not only from the detailed provisions of the Refunding Agreement, but also from the fact that the original obligation was still preserved even though refunding bonds were issued, owners of refunding bonds can be considered as among those authorized to give consents first, to the filing of the Petition, and secondly, to the confirmation of the Plan. And not overlooking the provisions of the Act (Sec. 402) that, "security affected by the plan" means a security as to which the rights of the holder are proposed to be adjusted or modified materially by the **consummation of a composition agreement** and that those "payable without preference out of funds derived from the **same source or sources shall be of one class.**" (Sec. 403 (b)) (Emphasis ours).

POINT II

The View of the Circuit Court of Appeals that the Executed Majority Refunding was not complete so as to Accomplish a Changed Debt Status to that Extent, Conflicts with Decisions of the Florida Supreme Court.

The cited opinions of the Supreme Court of the State of Florida,—State ex rel Garland v. City of Palm Beach, 193 So. 297, State v. West Palm Beach, 193 So. 839, cannot be considered as a rule and guide to the Bankruptcy Court in construing either the Act or an amendment to the Municipal Bankruptcy Act. (See also Block v. City of West Palm Beach, 112 F. (2d) 949).

The Garland case was one where the non-assenting bondholders sought to secure payment of their bonds

at one hundred cents on the dollar from levies that had been made by the City under the provisions of the State Refunding Act of 1931 (Chapter 15772, Oct., 1931, Sec. 2383 (1 to 34), C. G. L. Florida, 1927, Permanent Supp.) The language of the court in the West Palm Beach case is merely argumentative and used for the purpose of supporting the erroneous contention of the Petitioners for Writ of Certiorari in this case.

The Court in the latter case had nothing before it but the question of the validation of bonds proposed to be issued by the City of West Palm Beach under the Refunding Act of 1931.

In seeking to support their theory that the bondholders who have accepted refunding bonds should be considered as one class and bondholders who have not refunded should be considered as another class, the Petitioners for the writ have overlooked the decision of the Circuit Court as well as the definitions in the statute itself as to what creditors constitute a **class or classes under the law.**

In Vallette et al. v. Vero Beach, supra, the Court said:

> "The Act, Sec. 83(b), declares that at the hearing or a continuance thereof, if the allegations of the petition are sustained, 'the judge shall classify the creditors according to the nature of their respective claims and interests; provided, however, that the holders of all claims, regardless of the manner in which they are evidenced, which are payable without preference out of funds derived from the same source or sources

> shall be of one class. The holders of claims for the payment of which specific property or revenues are pledged, or which are otherwise given preference as provided by law, shall accordingly constitute a separate class or classes of creditors'."

The court in this case had before them the question of whether there is any lien or preference because of the grant of a mandamus, either before or after judgment. Should the law permit a preference, it seems to us that this (Vallette case) is a much stronger case in favor of a preference or separate classification. Here the bondholder has sought court action and merged his obligations into an enforcible judgment and seemingly would be entitled to a separate classification over those non-assenting bondholders who have taken no action.

But in reference to the claim of the judgment holders the court said in the Vallette case:

> "No law gives them any preference. They fix no vested right in any existing thing which the bankruptcy power could not touch or which could not be arrested by injunction under Sec. 83 (c). The judge rightly held that all bonds and coupons were payable from the same source, to-wit, general property taxation, whether evidenced by judgment or otherwise, and were to be classed together under the Act."

No one contends that the Homestead bonds are to be paid in any manner except by ad valorem taxation, and, therefore, under the law are classed together under the Act.

POINT III

The Circuit Court of Appeals Construed the Bankruptcy Act to be Applicable to a Proceeding which is beyond the Scope of Bankruptcy Compositions.

Reliance is placed in the language used by the court in In re City of West Palm Beach, Fla., Fifth Circuit, 96 F. (2d) 85, and other cases, to support the contention that the amendment, subsection (j) should not be controlling in this case in spite of the fact that the amendment was passed by the Congress to provide a remedy for the precise situation in which the City of Homestead finds itself. The report of the Committee of the Judiciary accompanying H. R. 10753 (Report No. 2693, 75th Congress, 3rd Sess.), clearly shows the intent of the Congress.

The court in American National Bank v. Sanford, 112 F. (2d) 435, likewise thought the same when they said:

> "That the amendment was intended to reach and provide a remedy for the precise situation in which the City of Sanford finds itself, we think there can be no doubt. From the report of the Committee of the Judiciary accompanying H. R. 10753, it plainly appears that it was passed to meet the situation dealt with in our opinion in Re City of West Palm Beach, Florida, 5 Cir., 96 F. 2d 85. We think it equally clear that the amendment, if valid, is effective to meet and provide a remedy for that situation. It declares that the fact that the 'partial completion or exe-

> cution of any plan of composition occurred before the filing of the petition, shall not be construed as limiting or prohibiting the effect of this act' and it specifically provides 'the written consents of the holders of any securities outstanding as the result of any such partial completion or execution of any plan of composition shall be included * * * in determining the percentage of securities affected by such plan.' It would be difficult to employ plainer language. We therefore reject as wholly without merit appellant's first and second contentions that the amendment was not intended to, and does not in terms, authorize the filing and, if the conditions of the act are met, the approval of the voluntary plan, as a plan of composition in bankruptcy."

The confusion of Counsel for Petitioners over the terms "refunding agreements and contracts," "arrangements for unsecured debts," "reorganizations," "compositions," "municipal debt adjustments" is largely responsible for the untenable position in which they find themselves at this time.

> "The intent of the parties to a contract is not to be determined by the 'label' of the agreement, but rather it is to be gathered by considering all of the acts, statements and writings which go to make up the contract (Ketchum v. Duncan, 96 U. S. 659; 24 L. Ed. 868)." In re Lindsay-Strathmore Irr. Dist., 25 F. Supp. 988.

Generally, "A composition with creditors is an agreement made by an insolvent or embarrassed

debtor with two or more of his creditors by which such creditors agree to receive a certain portion in full satisfaction of their claims." 15 C. J. S. 671.

As an agreement and method of adjustment, " 'Composition,' as concerns debtor, is an agreement with creditors in lieu of distribution of debtor's property in bankruptcy, and, as concerns dissenting creditors, composition is method of adjustment among creditors of rights of property in which all are interested." Louisville Joint Stock Land Bank v. Radford, supra.

As great progress was made in the ordinary bankruptcy proceedings over a long number of years, there has likewise been a belief that the bankruptcy power under the Constitution is ever expanding to meet the needs of not only railroads, farmers, wage earners and corporations, but now public debtors. This may be noted from the recent Acts of the Congress touching these various spheres in our financial structure.

In the field of public debtors we have found situations where proceedings were begun without a plan, as is evidenced by the proceedings in the Continental Ill, N. B. & T. Co. vs. C. R. I. & P. R. Co., 294 U. S. 648, 79 L. Ed. 1110, 55 S. Ct. 595.

With a re-adjustment plan submitted by a bondholders protective committee long before the passage of the Municipal Bankruptcy Act, as was done in the Luehrmann v. Drainage Dist. No. 7 case, supra, where practically all bonds were in the hands of the Recon-

struction Finance Corporation not as owner, but as pledgee with a plan of refunding. See also In re Lindsay-Strathmore Irr. Dist. 25 F. Supp. 988.

Without the bonds having been validated, such as has occurred in the Ft. Lauderdale case supra.

With a refunding plan and with all bonds validated ready for delivery, but not exchanged, as occurred in the Vallette v. City of Vero Beach case supra.

Now the case has progressed one step further where, with a refunding or adjustment plan, there has been a partial completion of the plan through exchange of bonds, and under the provisions of subsection (j), such plan may be considered as a plan of composition upon its being presented to the Court. See In re City of West Palm Beach, 96 F. (2d) 85; In re Corcoran Irr. Dist., 27 F. Supp. 322. (D. C. Cal.)

POINT IV

In Upholding an Application of the Act Beyond its Composition Scope, the Decision of the Circuit Court of Appeals Ignores Constitutional Barriers.

The substance of this contention is that Section 83 (j) is not an appropriate exercise of the bankruptcy power by the Congress. The recent decisions of this Court have shown a liberal attitude in their consideration of bankruptcy legislation as is evidenced by the language of Mr. Justice Sutherland in the case

of Continental Ill. N. B. & T. Co. v. C. R. I. & P. R. Co., supra, when he said:

> "The fundamental and radically progressive nature of these extensions becomes apparent upon their mere statement; but all have been judicially approved or accepted as falling within the power conferred by the bankruptcy clause of the Constitution. Taken altogether, they demonstate in a very striking way the capacity of the bankruptcy clause to meet new conditions as they have been disclosed as a result of the tremendous growth of business and development of human activities from 1800 to the present day. And these acts, far-reaching though they be, have not gone beyond the limit of congressional power; but rather have constituted extensions into a field whose boundaries may not yet be fully revealed."

At the time of the passage of subsection (j), this Court had sustained the constitutionality of the Municipal Bankruptcy Act. U. S. v. Bekins, 304 U. S. 27, 58 Sup. Ct. 811. The necessity requiring the passage of section 83 (j) was occasioned by the holding of the Circuit Court of Appeals for the Fifth Circuit, In re City of West Palm Beach case, supra. It may be judged from the report of the Committee of the Judiciary that the Municipal Bankruptcy Act should be amended in order that the purpose of the Act be not defeated by non-assenting creditors of municipalities which had partially completed refunding operations by the exchange of bonds prior to the passage of the Act. There can be no doubt that subsec-

tion (j) is appropriately related to the subject of bankruptcy and that its passage is within the constitutional power of the Congress.

Continental Bank v. Rock Island Ry.,
294 U. S. 648.

United States v. Bekins,
304 U. S. 27.

Wright v. Union Central Ins. Co.,
304 U. S. 502.

Louisville Bank v. Radford,
295 U. S. 555.

Local Loan Co. v. Hunt,
292 U. S. 234.

Hanover National Bank v. Moyses,
186 U. S. 181.

In re Reiman, Fed. Cas. No. 11,673.

We again find Petitioners here confused in their understanding of the "basic principles of composition." The language of the amendment is specific, is clear and certainly relates to the Act that it seeks to amend. The section is not in violation of either the Fifth or the Tenth Amendment to the Constitution of the United States.

> "(10-13). The constitutionality of the Act being beyond question (United States v. Bekins, 1938, 304 U. S. 27, 58 S. Ct. 811, 82 L. Ed. 1137; In re Drainage District No. 7, D. C. Ark. 1938, 21 F.

Supp. 798; In re City of Fort Lauderdale, D. C. Fla. 1938, 23 F. Supp. 229) and the reduction of debts being of the essence of the exercise of the power of bankruptcy, there is no violation of due process. U. S. C. A. Const. Amend. 14. Hanover National Bank v. Moyses, 1902, 186 U. S. 181, 22 S. Ct. 857, 46 L. Ed. 1113. We cannot, as urged by counsel for the objectors, consider the reduction in the face value of their security as a deprivation of property affecting the fairness of the plan. If that were true, no plan of composition or reorganization could ever be approved, because all of them deprive, indirectly, some creditor of some property right, either by reducing the principal or interest due him, or by extending the time of maturity of his debt. See Kuehner v. Irving Trust Co., 1936, 299 U. S. 445, 452, 57 S. Ct. 298, 81 L. Ed. 340." In re Corcoran Irr. Dist., 27 F. Supp. 328.

CONCLUSION

The Respondent, The City of Homestead, Florida, respectfully submits that from the Petition and Brief filed in this cause by the Petitioners for a Writ of Certiorari to the Circuit Court of Appeals for the Fifth Circuit, there appear to be no special or important reasons for the granting of the writ.

It clearly appears that there is no conflict in the decision of the Circuit Court of Appeals with any other decision rendered by another Circuit Court of Appeals and neither is there any conflict with any decision of the Supreme Court of the United States; that no important question of local law has been decided in conflict with applicable local decisions; that there is no emergency or necessity for the settlement by this Court of any question of Federal law.

WHEREFORE, Respondent, City of Homestead, Florida, prays that the Petition for Writ of Certiorari to the United States Circuit Court of Appeals, Fifth Circuit, be denied.

Respectfully submitted,

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